BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
L. N. HAGOOD AND MARY C, HAGOOD)

Appearances:

For Appellant: L. N. Hagood, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
Jack L. Rubin, Assistant Counsel

O P I N I O N

This appeal is made pursuant to Section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of L. N. Hagood and Mary C. Hagood for refund of personal income taxes in the amounts of $17.63, $142.75, $88.86, and $64.12 for the years 1953, 1954, 1955 and 1956, respectively.

The Appellants are residents of Wyoming. Prior to the years in question they acquired oil and gas leases from the United States, in public lands situated in California. The leases were given pursuant to Federal statute (41 Stat. 437, 30 U.S.C. §181, et seq. as amended). At various times during the years on appeal, Appellants granted options to several different oil companies with respect to the leases. Under each option agreement, Appellants gave the oil company the exclusive right to purchase the lease involved within 13 months and to carry on geological and geophysical exploration during that period. Each agreement provided for payment of a flat sum upon granting the option, an additional amount in the event the option was exercised and an overriding royalty of 5 percent on all oil and gas produced. Payments in all of these categories were received by Appellants in the years involved. The royalties, however, were in relatively minor amounts.

Appellants included in their personal income tax returns all of the above-described amounts. They concede that the royalties are taxable because they arose from operations in this State but they contend that they are entitled to refunds of the remaining amounts on the ground that the oil leases from the United States are intangible personal property, with a situs in Wyoming, the state of Appellants' residence or, in the alternative, that the payments cannot be taxed because Congress has not given its consent.

The Franchise Tax Board contends that the oil leases constitute realty. It therefore concludes that the source of the income involved was in this State and that the income is taxable to Appellants regardless of their place of residence. Aside from Appellants' Federal immunity argument, there is no question that the taxes were properly imposed if the leases constituted realty. (Shaffer v. Carter, 252 U. S. 37; Section 17041, formerly 17052, of the Revenue and Taxation Code; Title 18, California Administrative, Code, Section 17211-17214(c).)

The lease's in question were issued by the United States Department of the Interior under Section 17 of the Federal act as amended (30 U.S.C. §226). Each lease granted to Appellants "the exclusive right and privilege to drill for, mine, extract, remove, and dispose of all the oil and gas deposits, except helium gas, in the lands leased, ... for a period of-'T-years, and so long thereafter-as oil or--gas is produced in paying quantities ..." Appellants were entitled to an extension of the lease at the end of the 5-year period even in the absence of production unless the lands had been withdrawn from leasing. The lands could not be withdrawn if drilling had been commenced. Appellants were to pay an annual rental of 50 cents or $1.00 per acre, depending upon whether the lands were in a known geologic structure of a producing oil or gas field. Upon discovery of oil or gas on the land Appellants were required to pay a royalty of 12-1/2 percent or a minimum of $1.00 per acre. Any assignment of the lease was subject to approval by the lessor, The lease could be canceled for failure to comply with the provisions of the statute, the regulations thereunder, or the lease itself.

When the lessee in an oil lease between private parties is granted the right to drill for oil and gas for a term of years and so long thereafter as oil or gas may be produced in paying quantities, he unquestionably holds realty. (Dabney v. Edwards, 5 Cal. 2d 1.) If the terms of the grant are essentially those stated, the same conclusion follows even if the grant is called something other than an oil lease in the agreement and regardless of whether the lessor is a public agency. (County of L. A. v. Continental Corp., 113 Cal. App. 2d 207.)

Appellant seeks to distinguish the leases here involved from other oil leases by pointing to certain restrictions, the most significant of which are that the leases cannot be assigned without approval of the lessor and that they may be canceled for failure to comply with their terms. Such provisions, however, do not affect the basic character of the leases as grants of realty. (County of L. A. v. Continental. Corn,, supra.)

We conclude that the amounts received by the Appellants from the oil companies under the option agreements constitute income derived from real property located in this State., It is

subject to tax under the California Personal Income Tax Law unless there is merit to Appellants' claim that the State is precluded from asserting the tax under the doctrine of governmental immunity.

Appellants have presented no authority indicating that the consent of Congress is necessary to tax the income of a private party simply because the income arises from transactions involving property granted by the United States. It is clear to us that Congress did not intend to hedge the private rights of lessees of public lands with Federal immunities or restrictions. Section 32 of 41 Stat. 450 (30 U.S.C. §189) provides, in part:

> "... Nothing in said sections shall be construed or held to affect the rights of the States or other local authority to exercise any rights which they may have, including the right to levy and collect taxes upon improvements, output of mines, or other rights, property, or assets of any lessee of the United States."

In construing this section, the Supreme Court said in Mid-Northern Oil Co. v. Walker, 268 U. S. 45:

> "The contention on behalf of the company is that this proviso . . . relates to ... rights existing when the act was passed . . . . The more natural view, and the one we adopt, is that Congress, having provided for leasing the public lands to private corporations and persons whose property, income, business, and occupations ordinarily were subject to state taxation, meant ... to-say in effect that ... nothing in it shall be construed as to affect the right of the states ... to levy and collect taxes as though the government were not concerned."

The court went on to point out that the phrase "or other rights" was a residuary phrase not limited by the enumerations preceding it. We find no authority for any exemption based upon governmental immunity.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 19060 of the Revenue and Taxation Code, that the action

of the Franchise Tax Board in denying the claims of L. N. Hagood and Mary C. Hagood for refunds of personal income taxes in the amounts of $17.63, $142.75, $88.86 and $64.12 for the years 1953, 1954, 1955 and 1956, respectively, be and the same is hereby sustained.

Done at Sacramento, California this 14th day of November, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary